

5. Proprietary Equitable Remedies: Constructive Trust, Equitable Lien and Tracing

Proprietary equitable remedies are 'directed to' property -- they recognise, in the plaintiff's favour, some type of equitable interest in property in the defendant's or third party's hands. The key remedies are the constructive trust (full equitable interest) and the equitable lien (security interest). Unlike personal remedies, proprietary remedies can be enforced against third parties into whose hands the property passes, unless that party is a bona fide purchaser for value without notice (BFPFVWN).

RED FLAG -- TRIGGERS

- Fiduciary misappropriated plaintiff's property or diverted a corporate/partnership opportunity -- constructive trust (Category 1)
- Fiduciary received a bribe or secret commission -- constructive trust (Category 2)
- Defendant has become insolvent -- proprietary remedy gives priority over creditors; crucial to secure property
- Fiduciary mixed plaintiff's money with their own -- tracing; consider severable/unseverable property
- Third party received fiduciary property -- BFPFVWN rule; tracing into third party's hands

PROPRIETARY REMEDIES -- FRAMEWORK DETECTION

Type	How to Identify	Remedy Available
Constructive trust (Cat 1): misappropriation or diversion	Fiduciary (a) took plaintiff's property, or (b) acquired property by diverting an opportunity away from plaintiff	Full equitable interest -- plaintiff becomes beneficial owner; defendant holds as constructive trustee
Constructive trust (Cat 2): bribe/secret commission	Fiduciary received a bribe or secret commission in breach of duty	Constructive trust over bribe and its traceable proceeds -- AG for HK v Reid
Equitable lien	Plaintiff's money used to acquire property -- or to improve defendant's property; security interest in that property	Security over property for repayment of plaintiff's contribution
Tracing -- same hands	Plaintiff's money mixed with defendant's own money; need to identify what remains	Constructive trust (proportionate) or equitable lien over mixed fund/purchased property

Tracing -- third party	Property passed from defendant to third party; need to trace into third party's hands	No tracing against BFPFVWN; tracing against volunteers and those with notice
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5.1 Constructive Trust -- Category 1: Misappropriation or Diversion

When a fiduciary either (a) misappropriates the principal's property, or (b) diverts an opportunity away from the principal, the constructive trust operates institutionally -- it is declared as having come into existence at the date of the breach, not created at the date of judgment.

Boardman v Phipps [1967] 2 AC 46: Constructive trust imposed over shares acquired by co-agent fiduciaries who exploited information obtained in a fiduciary capacity. The trust was declared to exist from the date of acquisition.

Chan v Zacharia: Dr Chan held renewed lease on constructive trust for partnership from the date of its acquisition.

Category 1 is still a discretionary remedy in Australia: John Alexander's Clubs v White City Tennis Club (2010) 241 CLR 1 (French CJ, Gummow, Hayne, Heydon, Kiefel JJ at [128]): 'A constructive trust ought not to be imposed if there are other orders capable of doing full justice.'

Discretionary third party considerations: Grimaldi (Finn, Stone, Perram JJ at [254]): Court considers impact on innocent third parties and whether a long-term unwanted business relationship would result from the trust.

Victoria University of Technology v Wilson [2004] VSC 33 (Nettle J at [221]): Constructive trust imposed over shares in corporate vehicle (not software itself) -- 'fits the facts' and avoids adverse effects on innocent parties.

Constructive trust on terms: Conditions its imposition on the principal first paying the fiduciary their outlay in acquiring the property -- equitable maxim 'to receive equity you must do equity' (*Huang v Wang* [2016] NSWCA 164).

5.2 Constructive Trust -- Category 2: Bribes and Secret Commissions

AG for HK v Reid [1994] 1 AC 324: Mr Reid, a Hong Kong public prosecutor, accepted bribes to obstruct prosecutions. Privy Council held that the Crown was entitled to a constructive trust over the bribe (and any property acquired from the bribe) from the moment it was received.

The constructive trust in this context arises immediately upon receipt of the bribe -- the fiduciary holds the bribe on constructive trust for the principal.

For the definition of bribe/secret commission: Grimaldi at [189]-[193] (Finn, Stone, Perram JJ).

SCRIPT: CONSTRUCTIVE TRUST -- CATEGORIES-BASED ANALYSIS

Step 1: Category identification: Does the fiduciary's breach fall within (a) misappropriation/diversion, or (b) receipt of bribe/secret commission?

- -> Category 1(a) -- misappropriation: fiduciary takes and retains the principal's existing property.
- -> Category 1(b) -- diversion: fiduciary acquires new property by diverting an opportunity away from the principal (*Chan; Boardman*).
- -> Category 2 -- bribe/secret commission: fiduciary receives bribe from third party in breach of duty (*AG for HK v Reid*).
- -> COUNTER-ARGUMENT: [D] may argue the acquisition was not a diversion of the principal's opportunity but an entirely separate transaction unconnected to the fiduciary role, or that the property was acquired before the fiduciary relationship was established.

WRITE: The constructive trust arises [in the category 1 setting (misappropriation/diversion) / in the category 2 setting (bribe/secret commission)]. [D]'s breach involved [D] [taking [P]'s property / diverting an opportunity [P] was entitled to pursue / receiving a bribe from [third party]].

Step 2: Discretion: Even in category 1, the court retains a discretion as to whether to impose a constructive trust (*John Alexander's Clubs at [128] -- other orders capable of doing full justice; Grimaldi -- innocent third party impact*).

- -> IF personal remedy (account of profits) will do full justice: constructive trust may not be imposed.
- -> IF third party interests would be adversely affected: court may impose trust only over part of property (*VUT v Wilson -- shares not software*) or impose on terms.
- -> Constructive trust on terms: principal must pay fiduciary's outlay before receiving the benefit of the trust.
- -> COUNTER-ARGUMENT: [Plaintiff] may argue that only a constructive trust, not an account of profits, will do full justice because [D] may be insolvent / the property has uniquely increased in value.

WRITE: The constructive trust [should / should not] be imposed. [There are no other orders capable of doing full justice -- the account of profits remedy is insufficient because [D] is insolvent / the property has uniquely increased in value, following John Alexander's Clubs / an account of profits is capable of doing full justice, and a constructive trust would be disproportionate]. [Innocent third party considerations [do / do not] apply, following Grimaldi, because [facts about third parties].]

5.3 Equitable Lien

An equitable lien is a security interest over property -- it does not give the plaintiff full ownership but gives a right to have the property sold to satisfy the secured amount.

Arises where the plaintiff's money has been used to acquire (or improve) property held by the defendant.

Available as an alternative to the constructive trust in tracing situations: where mixed property is severable, plaintiff may choose either a proportionate constructive trust or an equitable lien securing repayment of their contribution (*Brady*).

If the value of property has fallen, the equitable lien secures only the amount contributed (not the loss in value) -- plaintiff may prefer a constructive trust in this case.

If the value of property has risen, the constructive trust gives the plaintiff a proportionate share of the increase -- plaintiff will prefer the constructive trust.

5.4 Equitable Tracing -- Same Hands

Equitable tracing allows a plaintiff to follow their property (or its proceeds) into the hands of the defendant and assert a proprietary interest over it.

Condition: The plaintiff must hold an equitable proprietary interest in the property from the outset -- the constructive trust (arising at the date of breach) satisfies this.

Step 1 -- Has the property been dissipated? If plaintiff's money has been spent on something with no remaining value (gambling, consumption), it is gone and cannot be traced.

Step 2 -- Has it been mixed with the defendant's own money? Three scenarios:

(a) Lowest amount rule: The plaintiff's entitlement cannot exceed the lowest intermediate balance in the mixed account at any time between misappropriation and claim.

(b) Severable property (e.g. shares): plaintiff chooses between (i) proportionate constructive trust over part of the shares, or (ii) equitable lien over the whole (*Brady*).

(c) Unseverable property (e.g. a house): plaintiff chooses between (i) proportionate constructive trust over the house (e.g. 50% share), or (ii) equitable lien plus a claim for increase in value (*Brady; Scott*).

Multiple innocent principals' moneys mixed: Clayton's case (FIFO) approach abandoned as inequitable. Two alternatives: (1) Simple pari passu -- share remaining funds proportionately to contributions (*Re French Caledonia Travel, Campbell J*); (2) Lowest intermediate balance rule -- rateably reduces each depositor's share whenever there is a withdrawal (*Caron v Jahani (No 2)* [2020] NSWCA 117, Bell P at [14]).

SCRIPT: EQUITABLE TRACING -- SAME HANDS

Step 1: Can the plaintiff trace?: Is the plaintiff's property still 'identifiable' in the defendant's hands? Has it been dissipated (spent on no remaining asset)?

- -> IF money spent on gambling, food, general living expenses: dissipated -- cannot trace.

- -> IF money used to purchase an asset: traceable into the asset.
- -> IF money used to improve a third party's existing asset: Re Diplock rules apply (see below).
- -> Lowest intermediate balance: plaintiff's claim cannot exceed the lowest amount in the mixed account at any point -- cannot 'top up' their claim by later deposits.
- -> *COUNTER-ARGUMENT: [D] may argue the money was spent on items with no remaining identifiable value -- it is dissipated and cannot form the subject of a proprietary claim.*

WRITE: [P]'s money [can / cannot] be traced. The [amount] [was / was not] used to purchase [asset], which remains in [D]'s hands and is identifiable as representing [P]'s contribution. [The remainder of \$[amount] was spent on [gambling/consumption] and has been dissipated -- it cannot be traced.]

Step 2: Mixed funds: Is the mixed property severable (shares, cash) or unseverable (real property)?

- -> Severable: plaintiff may choose (i) proportionate constructive trust over [proportion] of the shares -- [e.g. \$500 of \$1000 = 500/1000 shares]; or (ii) equitable lien over the whole securing repayment of [P]'s contribution.
- -> Unseverable: plaintiff may choose (i) proportionate constructive trust (e.g. half share of house); or (ii) equitable lien plus share of increase in value (*Brady; Scott*).
- -> *COUNTER-ARGUMENT: [D] may argue [P] should be limited to the equitable lien (not the constructive trust) because [D] contributed the greater part of the purchase price and a full constructive trust share would be disproportionate.*

WRITE: The mixed property is [severable / unseverable]. [P] may elect: (i) a proportionate constructive trust over [proportion] of the [asset] (representing [P]'s contribution of \$[amount] out of total \$[amount]); or (ii) an equitable lien securing repayment of [P]'s contribution of \$[amount], [plus a share of any increase in value (*Scott*) if unseverable]. [P] should elect the [constructive trust / equitable lien] because [the asset has [increased / decreased] in value].

5.5 Equitable Tracing -- Third Party Hands

A principal can trace into the hands of a third party as long as the property remains identifiable and the third party is not a BFPFVWN.

Third party who is a BFPFVWN: plaintiff's equitable interest is defeated -- cannot trace.

Third party who is a volunteer (received as gift) or has notice of the breach: plaintiff can trace.

This is different from *Barnes v Addy* first limb liability: tracing is easier (no knowledge requirement) and leads to a proprietary remedy; first limb knowledge receipt liability requires knowledge but is merely personal.

Re *Diplock* [1948] Ch 465 -- third party tracing principles: (a) Can trace into innocent third party's mixed bank account; (b) Can trace into property the volunteer purchased from that account -- but only equitable lien (not full constructive trust); (c) Cannot trace into property the volunteer has already improved or altered; (d)

Money used in general operations deemed dissipated; (e) Money used for secured debt -- Heperu v Belle: if mortgage payments traced, plaintiff can assert proprietary interest over the secured property.

SCRIPT: TRACING INTO THIRD PARTY HANDS (Re Diplock)

Step 1: BFPFVWN test: Is the third party a bona fide purchaser for value without notice of the plaintiff's equitable interest?

- -> IF BFPFVWN: plaintiff's equitable interest is extinguished -- cannot trace.
- -> IF volunteer (received as gift): can trace into their hands.
- -> IF third party with notice: can trace into their hands.
- -> *COUNTER-ARGUMENT: [D/third party] may argue they are a BFPFVWN because they gave valuable consideration and had no actual or constructive notice of the plaintiff's prior equitable interest in the property.*

WRITE: *[Third party] [is / is not] a BFPFVWN. [Third party] received the property [as a gift / without giving valuable consideration / with notice that [D] held it subject to [P]'s equitable interest]. [P] [can / cannot] trace into [third party]'s hands.*

Step 2: Re Diplock third party rules: What has the third party volunteer done with the property?

- -> Mixed into bank account: plaintiff can trace into that account (pari passu or lowest intermediate balance with other depositors).
- -> Used to purchase new asset: plaintiff can trace into the asset -- equitable lien only (*Re Diplock -- no evidence of increase in value addressed*).
- -> Used to improve own existing property: plaintiff cannot trace into the improved/altered property.
- -> Used for general operations: deemed dissipated -- cannot trace.
- -> Used to pay off secured debt: if traceable proceeds used for mortgage payments, Heperu v Belle allows plaintiff to assert proprietary interest over the secured property.
- -> *COUNTER-ARGUMENT: [Third party] may argue the money was used for [general operations / improvements to their own existing property] and is thus untraceable under Re Diplock.*

WRITE: *[Third party] used [P]'s traceable proceeds to [purchase [asset] / pay rent / pay mortgage on [property] / improve their own property]. Applying Re Diplock, [P] [can / cannot] trace into those [proceeds / the purchased asset / the property]. [P]'s remedy is [an equitable lien over the purchased asset / a proportionate interest in the mortgaged property (Heperu) / nil because the money was [improved/dissipated]].*

5.6 Tracing Calculation Guide

PRELIMINARY QUESTION: Can the Plaintiff Trace at All?

Condition	Result
Plaintiff held an equitable proprietary interest in the funds at the time of misappropriation (constructive trust arising at date of breach)	Tracing is available -- can trace into hands of defendant and third parties
Plaintiff has no prior equitable interest -- merely a personal claim (creditor, not beneficiary)	Equitable tracing is NOT available -- pursue personal remedies only
Property has been fully dissipated (gambling, general living expenses, services consumed)	Tracing is LOST -- no asset remains to attach the proprietary interest to
Third party is a BFPFVWN	Tracing is DEFEATED against that third party -- equitable interest extinguished

SCENARIO 1: Defendant Spends All of Plaintiff's Money on One Identifiable Asset

Facts: Trustee misappropriates \$50,000 of P's money and uses all of it to purchase shares now worth \$80,000.

Step 1 -- Is property identifiable? YES -- the shares are a specific identifiable asset purchased entirely with P's traceable funds.

Step 2 -- No mixing: All of the purchase price came from P's money. P is entitled to the full asset.

Result: P may claim a CONSTRUCTIVE TRUST over all of the shares (now worth \$80,000). P receives the full capital gain.

Alternative: P may instead claim an EQUITABLE LIEN over the shares securing repayment of \$50,000 only. P would choose the constructive trust here because the asset has increased in value.

If asset has DECREASED in value (now worth \$20,000): P should elect the equitable lien securing \$50,000, not the constructive trust over shares worth only \$20,000. The lien makes D personally liable for the shortfall.